



Hong Kong Law

January 2015

## SFC CONSULTS ON GREATER INFORMATION GATHERING POWERS ON LICENSED CORPORATIONS TO ASSIST OVERSEAS REGULATORS

Hong Kong's Securities and Future Commission (**SFC**) has begun a month-long consultation<sup>1</sup> on proposed amendments to the Securities and Futures Ordinance (**SFO**) to allow the provision of greater supervisory assistance to overseas regulators, upon request. Written responses to the consultation are required to be submitted by 16 January 2015.

The SFC's stated aim in making the proposed amendments is to align Hong Kong's provisions on the supervision of regulated multi-national entities with international standards. This in turn should lead to the entering into of more supervisory cooperation arrangements between the SFC and overseas regulators and access for Hong Kong regulated entities to those overseas markets which restrict entry to jurisdictions with mutual cooperation arrangements in place.

The extension of the SFC's powers under the proposed amendments is fairly limited: Sections 180 and 186 of the SFO would be amended to enhance the SFC's information gathering powers. The amendments would give the SFC the discretion (but not an obligation) to exercise its supervisory powers under Section 180 to obtain records or documents from an SFC-licensed corporation or its related corporation in relation to a regulated activity carried on by the SFC-licensed corporation, in order to assist overseas regulators in non-enforcement related matters.

<sup>1</sup> The SFC's "Consultation Paper on Proposed Amendments to the Securities and Futures Ordinance for Providing Assistance to Overseas Regulators in Certain Situations" of 19 December 2014 at <http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/openFile?refNo=14CP9>.

### Background

While the SFO provisions which allow the SFC to assist overseas regulators on enforcement matters meet international standards, its provisions allowing SFC assistance on supervisory matters fall short of international norms in one narrow respect: they do not permit the SFC to exercise its supervisory powers to obtain information in order to assist an overseas regulator in relation to non-enforcement matters. The proposed SFO amendments are intended to rectify this shortcoming.

The SFC considers it important that the SFC should be able to provide assistance on supervisory matters to overseas regulators since this will make it easier for Hong Kong to enter into supervisory memoranda of understanding (**MOUs**) with overseas regulators. To date, Hong Kong has entered only a handful of sector-specific supervisory MOUs and the SFC fears that the current limitation on its powers could adversely affect its ability to enter into further MOUs. This, in turn, could negatively impact the SFC's ability to obtain assistance from overseas regulators.

The difference between supervisory cooperation and cooperation in the enforcement context is important. In relation to enforcement, cooperation between regulators involves the investigation of suspected misconduct with the aim of obtaining evidence for use in legal proceedings. Supervisory cooperation, on the other hand, is primarily preventive in nature and involves the exchange of information which is not

intended to be used in legal proceedings. Its aim is to improve supervision of regulated entities with access to information from overseas regulators.

The SFC expects that the proposed amendments will afford Hong Kong regulated entities greater access to foreign markets since it should open up markets to which access is restricted to parties in jurisdictions with international supervisory cooperation arrangements.

## Current Framework

The SFC enjoys supervisory and investigatory powers under Section 180 and Sections 182 and 183 of the SFO, respectively.

### Section 180 SFO

Section 180 entitles the SFC to inspect and make enquiries of licensed corporations without having reasonable cause to believe that misconduct has taken place. However, the SFC can only exercise its powers under this section to determine whether a licensed corporation or its associated entity is in compliance with the Hong Kong regulatory provisions specified in Section 180(2) SFO, which include any SFO provision, any provision of the SFO's subsidiary legislation and any terms or conditions to which an SFC licence is subject. Although information obtained by the SFC on exercise of its supervisory powers under Section 180 is not sought for enforcement purposes, the information could be used in its disciplinary proceedings where appropriate.

### Sections 182-183 SFO

These provisions enable the SFC to investigate where it has reasonable cause to believe that a person may have engaged in defalcation, fraud, misfeasance or other misconduct in connection with dealing in securities etc. or that market misconduct may have taken place.

## Existing SFO Provisions regarding SFC Assistance to Overseas Regulators

The SFO contains the following provisions in relation to giving assistance to overseas regulators.

### Section 186 SFO

Section 186 allows the SFC to exercise its investigatory powers under Sections 182 and 183 SFO if it receives an enforcement-related request from an overseas regulator for assistance in

investigating suspected contraventions of certain legal or regulatory requirements, provided that certain conditions are met. To exercise its powers, the SFC must be satisfied that:

- i) It is desirable or expedient that the assistance should be provided in the interest of the investing public or in the public interest, or that the assistance will enable or assist the overseas regulator to perform its functions and it is not contrary to the interest of the investing public or to the public interest;<sup>2</sup> and
- ii) The overseas regulatory body performs a similar function to that performed by the SFC or the Hong Kong Registrar of Companies, and is subject to adequate secrecy provisions.<sup>3</sup>

Additional safeguards are found in Section 186(6) of the SFO which provides that statements for which the maker has claimed the privilege against self-incrimination cannot be used by an overseas authority in criminal proceedings.

### Section 378(3)(g)(i) SFO

Section 378(3)(g)(i) of the SFO allows the SFC to disclose non-public information to overseas regulators for enforcement or supervisory purposes provided that certain conditions (as set out in section 378(5), 378(6)(a) and (b) SFO), which are essentially the same as the conditions to which the SFC's exercise of its powers under Section 186 are subject, are met.

## Existing Powers to Provide Information to Overseas Regulators

Accordingly, the SFC is currently entitled to provide non-public information to overseas regulators in two circumstances:

### i) For Enforcement Purposes

The SFC can obtain information under Section 186 SFO by exercising its enforcement powers (e.g. to investigate under Sections 182 and 183), and disclose such information to an overseas regulator under Section 378(3)(g)(i); and

<sup>2</sup> Section 186(3) SFO.

<sup>3</sup> Section 186(5) SFO.

## ii) For Enforcement or Non-enforcement Purposes

Where the information requested is already in the possession of the SFC at the time of the overseas regulator's request, the SFC can disclose it to an overseas regulator under Section 378(3)(g)(i).

However, Section 186 does not provide for the SFC to exercise its supervisory powers under Section 180 in order to provide assistance to an overseas regulator. Thus, while Section 180 allows the SFC to obtain information for its own supervisory purposes, the SFO currently contains no express provision enabling the SFC to exercise its supervisory powers to obtain information for the purposes of assisting overseas regulators in non-enforcement related matters.

## Proposed Changes

The proposed amendments would provide only a narrow form of supervisory cooperation in order to strike a balance between facilitating cross-border information exchange and safeguarding against excessive disclosure.

### *Nature of Assistance*

Under the proposed amendments, the SFC could only provide assistance in relation to:

- i) an SFC licensed corporation that is also regulated by the overseas regulator; and/or
- ii) a related corporation of an SFC-licensed corporation where the related corporation is regulated by the overseas regulator.

The term "related corporation" is defined in the SFO<sup>4</sup> to include:

- a holding company;
- a subsidiary;
- another subsidiary of the same holding company; and
- two or more companies where the same individual: (i) controls the composition of the board of directors of each company; (ii) controls more than half the voting power at general meetings of each company; or (iii) holds more than half of the issued share capital of each company.

The form of assistance would be limited to obtaining records and documents from the licensed corporation (or related corporation) which are otherwise not accessible to the overseas regulator and making enquiries about these and related transactions and activities. The information to be obtained would also have to relate to a regulated activity carried on by the licensed corporation, or a transaction or activity which was undertaken in the course of, or which may affect, a regulated activity conducted by the licensed corporation. The SFC could not therefore provide assistance in relation to information relating to an unregulated activity conducted by a licensed corporation (e.g. bullion trading).

However, the SFC would have no power under the amended provisions to enter a corporation's premises on behalf of an overseas regulator or to obtain information from parties other than licensed corporations and their related corporations.

### *Purposes of Collection*

The SFC would only be able provide assistance where its purpose is to allow an overseas regulator to determine:

- the risks to and the impact on the stability of the financial system in its jurisdiction; or
- compliance with legal or regulatory requirements (excluding tax) administered by the overseas regulator in relation to transactions and activities relating to securities, futures contracts, leveraged foreign exchange contracts, collective investment schemes, OTC derivative products or other similar transactions that it regulates.

The proposed amendments do not need to cover registered institutions since the Hong Kong Monetary Authority is already permitted to provide assistance to overseas regulators under the Banking Ordinance.

### *Safeguards*

#### Existing Safeguards

Assistance to overseas regulators would only be provided subject to the existing safeguards (as described above) which include the requirement that the SFC must be satisfied that its assistance to the overseas regulator is provided in the "public interest". In determining whether providing assistance would be in the "public interest", one of the factors the SFC must take into account is whether the overseas regulator making the request is able and willing to provide reciprocal assistance

<sup>4</sup> Section 3 of Part 1 of Schedule 1 to the SFO.

in response to a request for assistance from Hong Kong.<sup>5</sup> Further, a person from whom the SFC requests a statement in the exercise of its investigatory powers under Section 179 or 183 may assert privilege against self-incrimination under Section 186(6) SFO. In such a case, the SFC cannot provide the self-incriminating statement to an overseas regulator for use in criminal proceedings in its jurisdiction.

#### Additional Safeguards

Overseas regulators would additionally be required to provide written undertakings to the SFC that they will:

- only use information obtained from the SFC for the purposes of determining: (i) the risks to and the impact on the stability of the financial system in their jurisdiction; or (ii) compliance with legal or regulatory requirements (excluding tax) administered by the overseas regulator;
- not use the information in any proceedings unless the authority or regulatory organisation has sought, and the SFC has agreed to provide, such information in accordance with Section 186(1) SFO;
- treat information provided to them as confidential and will not disclose it to any other person without the SFC's approval;
- inform the SFC as soon as reasonably practicable if they are required to disclose any of the information under a legally enforceable demand, and take all appropriate steps to preserve the confidentiality of the information; and
- cooperate with the SFC in any actions or proceedings seeking to preserve the confidentiality of the information received.

It should be noted that the proposed amendments would not impose an obligation on the SFC to provide assistance to an overseas regulator requesting assistance: it would only give the SFC a discretion to provide assistance following a request.

#### **Overseas Comparison**

Appendix A to the consultation paper sets out a table showing the extent of assistance allowed to be provided by regulators in Australia, Singapore and the United Kingdom and the scope of the written undertakings required of the requesting overseas regulator as a condition to provision of such assistance.

<sup>5</sup> Section 186(4)(a)(ii) of the SFO.

#### **The Consultation Questions**

The consultation seeks responses to the following 4 questions:

**Question 1: Do you have any alternative suggestions to the proposals in this Consultation Paper which could also achieve the same objectives that the proposed amendments to sections 180 and 186 intend to achieve?**

**Question 2: Do you have any comments on the proposal that the purposes of supervisory assistance should be limited to those discussed in paragraph 25(b) of the Consultation Paper?**

**Question 3: Do you have any comments on the proposal that the power to gather information for supervisory assistance purposes should be limited to those discussed in paragraphs 25(a) and (c) of the Consultation Paper?**

**Question 4: Do you agree that there is a need to have the legal pre-requisite of obtaining written undertakings from the overseas regulators? Do you have any comments on the scope of the undertakings discussed in paragraph 25(d) of the Consultation Paper?**

#### **Response Submission**

Interested parties should submit comments on the proposals in writing on or before 16<sup>th</sup> January 2015:

- i) by on-line submission via the SFC website: (<https://www.sfc.hk/edistributionWeb/gateway/EN/consultation/comment?refNo=14CP9>)
- ii) by email to: [s180\\_186@sfc.hk](mailto:s180_186@sfc.hk)
- iii) by post to:  
  
Intermediaries Supervision Department  
Intermediaries Division  
Securities and Futures Commission  
35/F, Cheung Kong Center  
2 Queen's Road Central  
Hong Kong
- iv) by fax to: +852 2284 4660

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